BLANK PAGE

BLANK PAGE

INDEX

CITATIONS

286651—41

BLANK PAGE

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 437

CARTER H. HARRISON, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF ILLINOIS, PETITIONER

v.

SARA H. SCHAFFNER

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the District Court (R. 60) is not officially reported. The opinion of the Circuit Court of Appeals (R. 69) is reported in 113 F. (2d) 449.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 17, 1940 (R. 75). The petition for a writ of certiorari was filed September 14, 1940, and was granted November 12, 1940. The jurisdiction of this Court rests upon Section

240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

A life beneficiary of a residuary trust, in November and December, assigned to her children and son-in-law specified amounts in dollars of the income that might be derived from the trust during the ensuing year. The question is whether the assignor, by executing such assignments, was thereby relieved of tax upon such income.

STATUTE INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791;

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.
>
> * * * * *
>
> SEC. 161. IMPOSITION OF TAX.
>
> (a) *Application of tax.*—The taxes imposed by this title upon individuals shall

apply to the income of estates or of any kind of property held in trust, * * *

* * * * *

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

* * * * *

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. * * *

STATEMENT

The judgment of the District Court was entered (R. 62) pursuant to the taxpayer's motion (R. 59) for judgment on the pleadings. The pertinent facts, as established by the complaint (R. 2) and answer (R. 53), may be summarized as follows:

In 1918 the taxpayer, Sara H. Schaffner, became entitled to the income for life of a residuary trust established by the will of her husband (R. 3, 18–24, 38). On December 23, 1929, she irrevocably as-

signed in writing to her three children $84,000 of the net income that might be derived from the trust during the year 1930. Of the net income thus assigned, $36,000 was for one daughter; $30,000 for another daughter; and $18,000 for a son. (R. 3–4, 39–43, 54–55.)

On November 14, 1930, the taxpayer again executed irrevocable assignments of the net income of the residuary trust. These assignments, totalling $54,000, covered income that might be derived from the trust during the year 1931 only. Her daughter, her son, and the husband of a deceased daughter each received $18,000 (R. 4, 43–48, 55.)

The portions of the trust income thus assigned were paid by the trustee directly to the assignees (R. 4, 55.)

The taxpayer filed income-tax returns for the years 1930 and 1931 (R. 3, 54) but did not include in either any portion of the trust income thus assigned (R. 4, 55–56).

The Commissioner of Internal Revenue ruled that all of the assigned income was taxable to the assignor, and assessed a deficiency against her for the years 1930 and 1931. She paid the additional taxes (R. 5–6, 56–57), and brought this suit for refund.

The District Court held that the taxpayer was entitled to a refund (R. 62); the Circuit Court of Appeals affirmed (R. 75).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the income of the residuary trust which the taxpayer assigned should not have been included in her gross income.

2. In failing to hold that the income of the residuary trust which the taxpayer assigned was properly included in her gross income.

3. In affirming the judgment of the District Court.

SUMMARY OF ARGUMENT

This case is ruled by *Helvering* v. *Horst* and *Helvering* v. *Eubank,* recently decided by this Court. Without relinquishing her life estate, the taxpayer simply deflected income therefrom for a short period to members of her family. The *Horst* and *Eubank* cases, as well as other decisions of this Court, make it clear that such an assignment could not relieve the assignor of tax liability.

Blair v. *Commissioner,* 300 U. S. 5, is not opposed. There the owner of a life estate made an assignment of income therefrom to be paid annually during his entire life. The Court treated such an assignment as transferring not only income to the assignee but also a proportionate share of the assignor's entire life estate. If the *Blair* case be regarded as standing for more than this, it would be inconsistent with the other assignment of income cases. Thus, if the taxpayer in the *Horst* case had transferred the bonds in trust for himself and then assigned one year's

income to his son, it seems clear that the *Blair* case would not have required a different result. There is no magic in the trust device, the crucial issue being whether the taxpayer has parted with the underlying interest out of which the income flowed. The taxpayer here, unlike the assignor in the *Blair* case, did not part with her underlying property interest, i. e., her life estate, and therefore continued to remain liable with respect to the trust income.

ARGUMENT

THE LIFE BENEFICIARY REMAINED TAXABLE WITH RESPECT TO THE ASSIGNED INCOME

1. The taxpayer is a life beneficiary of a trust. Without in any way relinquishing her life interest she carved out a portion of one year's income late in December 1929, and directed the trustees to pay the amount so designated to members of her family during the following year. The ritual was repeated in November 1930 with respect to the 1931 income of the trust. We submit that such assignments could not effectively relieve her of tax.

Like the owner of the coupon bonds in *Helvering* v. *Horst,* No. 27, present Term, the taxpayer simply reallocated income for a relatively short period within the family group without relinquishing the underlying property from which the income was separated. In the *Horst* case the property consisted of bonds; here the property consists of a life estate in a trust. We believe that there are no es-

sential differences between the two cases, and submit that the decision in the *Horst* case governs.

The rule applied in the *Horst* case and its companion case, *Helvering* v. *Eubank,* No. 205, followed established principles. *Lucas* v. *Earl,* 281 U. S. 111; *Burnet* v. *Leininger,* 285 U. S. 136; *Helvering* v. *Clifford,* 309 U. S. 331; see *Reinecke* v. *Smith,* 289 U. S. 172, 177; cf. *Corliss* v. *Bowers,* 281 U. S. 376; *Du Pont* v. *Commissioner,* 289 U. S. 685; *Burnet* v. *Wells,* 289 U. S. 670. And the facts in the instant case make the application of those principles particularly appropriate here. In every real sense the taxpayer exercised control over the flow of the income in question. She waited until the end of the year, when she could presumably budget her affairs with reasonable accuracy for the coming year and then directed the payment of a specified amount out of one year's income to members of her family.

2. The court below herein, like the lower court in the *Horst* case, relied heavily upon *Blair* v. *Commissioner,* 300 U. S. 5.[1] We believe that that case is consistent with our position, and should be no more controlling here than it was in the *Horst* case.

---

[1] The court below concluded that no legal difference existed between the instant case and *Blair* v. *Commissioner*, and its decision is in accord with two decisions of the Board of Tax Appeals in essentially similar cases. *Booth* v. *Commissioner*, 36 B. T. A. 141, affirmed without opinion, 103 F. (2d) 1008 (C. C. A. 6th); *Whitcomb* v. *Commissioner*, 37 B. T. A. 806, affirmed without opinion, 103 F. (2d) 1009 (C. C. A. 6th).

In the *Blair* case the life beneficiary of a testamentary trust assigned *for the duration of his life* a specified portion of the income to which he was entitled, and this Court held that he was not taxable on the income thus paid to the assignee. But that decision proceeded upon the theory that the donor had disposed, not merely of his right to income, but also of his entire proportionate life interest. Indeed, the Court referred to the language of the assignment, and stated (p. 13):

> We think it apparent that the conveyancer was not seeking to limit the assignment so as to make it anything less than a complete transfer of the specified interest of the petitioner as the life beneficiary of the trust, but that with ample caution he was using words to effect such a transfer. * * *

The *Blair* case thus constitutes an exception to the general rule: normally, the assignor may not relieve himself of tax by deflecting his income, but where he is merely a life beneficiary and strips himself of his entire property interest in the trust, he may avoid tax upon the income flowing from that property which is thereafter paid to the donee. Such, we believe, was the interpretation of the *Blair* case in the prevailing opinion in the *Horst* case, where it was said:

> In the circumstances of that case the right to income from the trust property was thought to be so identified with the equitable ownership of the property from which alone the beneficiary derived his right to receive

> the income and his power to command disposition of it that a gift of the income by the beneficiary became effective only as a gift of his ownership of the property producing it. Since the gift was deemed to be a gift of the property the income from it was held to be the income of the owner of the property, who was the donee, not the donor, * * *

We believe that the foregoing language must have been intended to refer to the property interest of the equitable life tenant all of which had been given away. It certainly could not have been meant to suggest that every irrevocable assignment of trust income effectively frees the assignor of tax liability on the theory that trust income is inextricably bound up with the underlying property. For, in that view, it would simply have been necessary for Mr. Horst to transfer his bonds in trust for himself and then to assign to his son the trust income about to be realized. We submit that the result in the *Horst* case rests upon no such metaphysical distinction, and whether the income stems from a trust or whether it springs directly from legal ownership of property, the tax thereon may not be avoided by an anticipatory assignment unless the owner has parted with the underlying interest out of which the income flows. The underlying interest in the *Horst* case was a bond; here it is a life estate. In neither situation did the assignor part with that underlying interest; in each case the assignor simply released income for a brief period. In the *Blair* case, on

the other hand, the taxpayer gave up a portion of his entire life interest, and to that extent succeeded in avoiding tax liability.

In the instant case the taxpayer has not disposed of her life interest, and there is therefore no occasion for invoking the *Blair* case. Indeed the Court in the *Horst* case analogized the *Blair* case to an assignment of rent from a lease "after the leasehold * * * had been given away", the plain inference being that if the owner of the leasehold had not given it away he would remain taxable upon any rent that he had assigned. Similarly here, the owner of a life estate like the owner of the leasehold has simply parted with a limited amount of future income, and should not thereby be relieved of tax thereon.

CONCLUSION

The judgment of the court below should be reversed.

Respectfully submitted.

Francis Biddle,
Solicitor General.
Samuel O. Clark, Jr.,
Assistant Attorney General.
Sewall Key,
Arnold Raum,
Edward First,
Special Assistants to the Attorney General.

January 1941.

U. S. GOVERNMENT PRINTING OFFICE: 1941

BLANK PAGE